Loudoun County Government Reform Commission
Memorandum

To: Loudoun County Board of Supervisors

From: Loudoun County Government Reform Commission (LCGRC)

Re: Observations Concerning County Debt Structure

Date: Monday, July 30, 2012

Based on well-justified concerns (given the present crisis at the Federal level) over public sector debt, the LCGRC undertook a high level analysis of County debt with the objective of understanding the sustainability of current debt management practices.

Executive Summary

- County Fiscal Policy has created long-term stability with respect to County debt structure. As a result of following Fiscal Policy with discipline, Loudoun weathered the 2008-2010 down turn quite well.
- The current five year plan shows continued sustainability based on adherence to adopted Fiscal Policy. In fact, sensitivity analysis (based on projecting a substantial miss to the downside compared to current projections) shows that Loudoun can manage well in the event of economic volatility.
- This shock-resistance and well-structured debt arises as a direct result of more than 20 years of following a well-conceived Fiscal Policy.

Therefore, the Government Reform Commission strongly recommends that the Loudoun County Board of Supervisors continues to adhere to and maintain the institutionalization of the existing Fiscal Policy. A key element of this is maintaining the flexibility to defer or eliminate planned debt issuances as economic conditions vary.

Historical and Current Landscape

In 1984 the Board of Supervisors adopted the core of what remains current Fiscal Policy with the explicit goal of attaining AAA credit status for Loudoun. By 2004 the County did indeed attain AAA credit status, which it has retained ever since. One must state that the rating agencies do not give hard and fast guidelines as to what constitutes AAA status, but the adoption of and adherence to a Fiscal Policy that includes key financial metrics lies at the heart of rating agency analysis. In June of this year, the County met with the relevant rating agencies and feedback indicates that Loudoun remains quite credit worthy with every expectation of retaining AAA status.

The key financial metrics, which have remained consistent for more than a decade, are:

- Ratio of total debt to estimated property value cannot exceed 3%
    - This reflects the ability of the County to repay debt as a function of its tax base
- Ratio of debt to per capita income cannot exceed 8%
    - This reflects the ability of citizens to pay the taxes that are required to repay debt
- Ratio of debt service to current expenditures cannot exceed 10%
    - This reflects whether or not debt service results in starving the County of current cashflow
- Ratio of debt to be repaid within ten years to total must exceed 60%
    - This reflects proper matching of debt issued to the life of the assets financed by that debt

The County typically issues debt on a fixed interest rate basis with two lengths of maturity: 7 year issues pursuant to fixtures and equipment, and 20 year issues pursuant to physical structures. As a result of this blend, the majority of County debt has a payoff period of 10 years or less and at present the County pays off approximately 7% of its debt annually.

If one analyzes the five year plan of 2007 and compares the forecast in 2007 to the actual situation in 2012, one will see a tremendous delta between the expectations and the reality (see attached spreadsheet and compare yellow and orange sections). By way of example, actual property value was 39% less than the original projection. Given the sensitivity of the key financial metrics, this could have been a fiscal disaster for the County. However, during the actual event the Board of Supervisors, with the cooperation of the School Board, hewed to the County's Fiscal Policy and curtailed the issuance of debt. As a result, the County maintained its financial metrics, retained its credit rating, and kept debt at affordable levels through the downturn (see yellow section of attached spreadsheet).

Essentially, the Fiscal Policy has become institutionalized in Loudoun County. The discipline that it imposes, as well as the fact that the BOS has accepted that discipline, served the County very well when it was needed most.

Sensitivity of Existing Five Year Plan

As a method of examining the reasonableness of the planned debt structure in the existing five year plan, we applied a worst-case scenario to the forecasted numbers to see what the result would be. To establish such a worst-case scenario, we looked at the original forecast for 2012 that was made in 2007. Inasmuch as the downturn of 2008-2010 was not anticipated in 2007, but rather the expectation had been for continued economic growth at the time, we reasoned that this historical miss likely would be as bad as anything that the future economy could throw at us. See the green section of attached spreadsheet. Indeed, there were large misses on key drivers of financial metrics:

	Forecast	Actual	Variance	Variance %
Per Capita Income	64,422	55,056	(9,366)	(15%)
Property Value	96 billion	58 billion	(38 billion)	(39%)
Population	344,368	319,000(25,368)	(7%)	

We then applied these same misses (by percent variance) to the existing 2016 forecasts (orange section of attached spreadsheet) to project the impact on financial metrics. This brought us the following results (red section of attached spreadsheet):

	Forecast	Worst Case
Per Capita Income	65,191	55,713
Property Value	73 billion	44 billion
Population	345,751	320,000

Under this worst case scenario, we see that income and population stagnate at current levels and property values would drop to about 2/3rds of actual 2006 levels. Particularly on the property aspect, this would be a financial Armageddon, which one hopes never to see!

Even under this scenario, however, Loudoun would have more than a fighting chance based on the fact that its existing debt structure is under control. Loudoun's debt to property value would be at 4% (over our target of 3%) and our debt to per capita income would be at 9% (over our target of 8%). The solution would be to curtail debt issuance by approximately $200 million in the intervening timeframe, which would reduce total debt from $1.6 billion to $1.4 billion. With that reduction Loudoun would once again be within its targeted ratios.

The conclusion that we reach is that Loudoun can weather economic hardship, so long as it continues to manage to the Fiscal Policy and retain the flexibility to curtail debt issuance in response to economic fluctuations. Our view, therefore, is that the plan for the worst case should include strategies to mitigate capital expenditures in the event that Loudoun's balance sheet cannot support debt issuance. By way of example of such strategies, we point to our recommendations concerning Year Round Schooling.

Impact on Future Debt Ratios (1)
Adopted FY 12 - 16 Capital Improvement Program
FY 12 Adopted Fiscal Plan

	Actual Results						Projections					Worst Case Scenario	
	FY 06	FY 07	FY 08	FY 09	FY 10	FY 11	FY 12	FY 13	FY 14	FY 15	FY 16	Apply 2012 Var	Revised Proj
Beginning Net Tax Supported Debt							$1,164,624,500	$1,244,509,282	$1,300,632,657	$1,422,239,122	$1,499,374,674		
New Debt Issued							183,210,000	164,325,000	237,299,000	201,091,000	253,190,000		
Retired Debt (Old)							103,325,218	94,815,194	92,503,087	87,111,000	84,385,000		
Retired Debt (New)							0	13,386,431	23,189,448	36,844,448	49,784,448		
Ending Net Tax Supported Debt							$1,244,509,282	$1,300,632,657	$1,422,239,122	$1,499,374,674	$1,618,395,226		
Population	262,647	271,177	278,591	283,315	289,977	319,917	318,596	324,500	331,229	338,387	345,751	-7%	319,876
Percent Change		3%	3%	2%	2%	10%	0%	2%	2%	2%	2%		
Public School Enrollment							66,266	69,323	72,395	75,011	77,437	-5%	73,613
Estimated Property Value (in Millions)	$ 65,336	$ 67,127	$ 67,097	$ 60,851	$ 58,496	$ 60,161	$58,103	$61,513	$65,373	$68,986	$72,592	-39%	44,087
Percent Change		3%	0%	-9%	-4%	3%	-3%	6%	6%	6%	5%		
Per Capita Income	$ 44,617	$ 46,621	$ 50,884	$ 51,083	$ 50,951	$ 53,117	$55,056	$58,039	$61,184	$63,304	$65,191	-15%	55,713
Percent Change		4%	9%	0%	0%	4%	4%	5%	5%	3%	3%		
Expenditures (in Thousands)	$ 1,268,524	$ 1,446,620	$ 1,568,548	$ 1,895,186	$ 1,774,734	$ 1,800,456	$1,597,204	$1,677,064	$1,802,844	$1,938,057	$2,083,412		
Percent Change		14%	8%	21%	-6%	1%	-11%	5%	8%	8%	7%		
Debt Service	$ 112,877,657	$ 122,205,086	$ 138,365,448	$ 141,921,045	$ 138,679,732	$ 163,843,477	$158,668,109	$167,347,029	$178,560,060	$192,444,045	$206,688,679		
Percent Change		8%	13%	3%	-2%	18%	-3%	5%	7%	8%	7%		Revised
Ratios:													Ratio
Debt to Estimated Property Value (3.0%)	1.45%	1.59%	1.49%	1.91%	1.99%	1.91%	2.14%	2.11%	2.18%	2.17%	2.23%		4%
Debt to Per Capita Income (8.0%)	8.08%	8.43%	7.05%	8.02%	7.88%	6.78%	7.10%	6.91%	7.02%	7.00%	7.18%		9%
Debt Service to Expenditures (10.0%)	8.90%	8.45%	8.82%	7.49%	7.81%	9.10%	9.93%	9.98%	9.90%	9.93%	9.92%		
Ten-Year Debt Payout Ratio (> 60%)							71.92%	71.61%	70.34%	70.08%	67.76%		
(Note: Numbers in parentheses represent Fiscal Policy target ratios.)													
Annual Debt Issuance Guidline:													
Debt Issuance Guideline							$200,000,000	$200,000,000	$200,000,000	$200,000,000	$200,000,000		
Debt Issuance Projected							$139,580,000	$112,325,000	$197,299,000	$140,171,000	$126,625,000		
Affordability Index: (2)													
Outstanding Debt Guideline							$1,434,823,120	$1,520,018,198	$1,615,591,244	$1,700,297,943	$1,783,985,591		
Outstanding Debt Projected							$1,244,509,282	$1,300,632,657	$1,422,239,122	$1,499,374,674	$1,618,395,226		
Overlapping Debt: (3)													
Overlapping Debt Guideline							$581,027,730	$615,130,227	$653,727,559	$689,858,590	$725,921,331		
Overlapping Debt Projected							$195,775,000	$187,390,000	$178,152,000	$168,240,000	$157,294,000		

(1) Debt includes general obligation bond and appropriation based financing.
(2) Affordability Index is the weighted average of Debt Per Capita (20%) / Debt To Estimated Property Value (45%) /
Debt to Per Capita Income (35%)
(3) Maximum outstanding Overlapping Debt allowed per Fiscal Policy guidelines is 1% of Estimated Property Value

Original Forecast in 2007

Impact on Future Debt Ratios (1)
Adopted FY 07 - 12 Capital Improvement Program
FY 07 Adopted Fiscal Plan

	FY 07	FY 08	FY 09	FY 10	FY 11	FY 12	Variance	Variance %
Beginning Net Tax S	$917,423,741	$1,039,508,960	$1,128,028,637	$1,192,089,843	$1,260,583,843	$1,306,828,227	($142,203,727)	-11%
New Debt Issued (2	199,500,000	177,885,000	167,230,000	174,150,000	163,420,000	188,820,000	($5,610,000)	-3%
Retired Debt (Old)	77,414,781	74,755,323	76,118,794	64,221,000	59,520,616	54,914,452	$48,410,766	88%
Retired Debt (New)	-	14,610,000	27,050,000	41,435,000	57,655,000	69,255,000	($69,255,000)	-100%
Ending Net Tax Sup	$1,039,508,960	$1,128,028,637	$1,192,089,843	$1,260,583,843	$1,306,828,227	$1,371,478,775	($126,969,493)	-9%
Population (3)	278,778	291,896	305,014	318,132	331,250	344,368	(25,771.86)	-7%
Public School Enroll	50,740	54,451	58,098	61,861	65,752	69,708	(3,442.00)	-5%
Estimated Property '	$63,171	$69,671	$76,171	$82,671	$89,171	$95,671	(37,568.23)	-39%
Per Capita Income (	$51,175	$53,570	$56,098	$58,768	$61,530	$64,422	(9,366.00)	-15%
Expenditures (in Th	$1,900,000	$2,185,000	$2,513,000	$2,890,000	$3,323,500	$3,822,025	(2,224,821.00)	-58%
Debt Service	$121,940,440	$140,684,773	$159,253,271	$165,705,310	$179,476,701	$189,217,745	(30,549,636.20)	-16%
Ratios:								
Debt Per Capita ($2	$3,729	$3,864	$3,908	$3,962	$3,945	$3,983		
Debt to Estimated P	1.65%	1.62%	1.57%	1.52%	1.47%	1.43%		
Debt to Per Capita I	7.29%	7.21%	6.97%	6.74%	6.41%	6.18%		
Debt Service to Exp	6.42%	6.44%	6.34%	5.73%	5.40%	4.95%		
(Note: Numbers in parentheses represent Fiscal Policy target ratios.)								
Maximum Outstanding Overlapping Debt Allowed Per Fiscal Policy Guidelines:								
1% of Assessed Prc	$631,710,000	$696,710,000	$761,710,000	$826,710,000	$891,710,000	$956,710,000		

(1) Debt includes appropriation based capital lease obligations. Does not include revenue bonds.
(2) Issued debt retirement rate assumes 20 year maturity on general obligations and capital lease obligations (level principal).
(3) Estimated population provided by the Department of Economic Development.
(4) Public school enrollment from the School Board Adopted Capital Improvements Program.
the Revenue is an estimate of the fair market value of all taxable real and personal property in the County, exclusive of fair
(6) Estimated per capital income provided by the Department of Economic Development.
(7) Estimated expenditures provided by the Department of Management & Financial Services.